



Multistate Tax Commission Memorandum

States Working Together Since 1967 . . . To Preserve Federalism and Tax Fairness

PUBLIC NOTICE AND AGENDA

Public Dialogue Meetings on Administrative Issues Related to Draft Factor Presence Nexus Standards and Preliminary Notice of Public Hearings

The Multistate Tax Commission has been developing a proposal for a simple and certain standard for income and franchise tax nexus. The proposal relies on the presence in a State of a threshold amount of any of the apportionment factors of property, payroll or sales as fairly representative of where a multistate company is doing business and earning income. A copy of the proposal is attached.

I. The Commission's Business Activity Tax Work Group is conducting two public dialogue meetings to focus on the administrative and technical workability of the proposal. These sessions will be conducted telephonically on

Monday, June 17, 2002 at 3:30 p.m. EDT

Dial-in # 703-326-5155

Access/pass code: 6047081

and

Friday, June 28, 2002 at 3:30 p.m. EDT.

Dial-in # 703-326-5155

Access/pass code: 6047094

The agenda for these two sessions is as follows:

- A. Welcome and Introductions
- B. Brief Summary of Proposal and Explanation of Public Input Process
- C. Public Comments and Dialogue
- D. Future Meetings and Public Hearing Process
- E. Adjournment

Persons wishing to participate in either teleconference should dial-in as indicated above. Alternatively, interested parties may come to the Commission's offices at 444 North Capitol St. NW, Suite 425, Washington, DC 20001-1538 and participate in the teleconferences from there. Written comments may also be submitted by June 28, 2002 to the above address, attention Frank Katz.

Because it would be helpful to know the approximate number of participants in the public dialogue teleconferences to ensure sufficient teleconference capacity, people are requested, but by no means required, to let Frank Katz know by June 14, 2002, of their intention to participate in the teleconferences.

II. The Commission will hold two formal public hearings on the proposal as well. This notice includes preliminary information concerning these hearings. A more formal notice of these hearings will follow.

The Executive Committee of the Commission will conduct the first hearing focusing on the constitutional, philosophical, theoretical and policy aspects of the proposal at the Commission's Annual Meeting on July 31, 2002 at 2:00 p.m. CDT at the Monona Terrace Convention Center, Madison Wisconsin.

A Hearing Officer will conduct the second formal public hearing pursuant to the Commission's procedures for adoption of uniformity recommendations is scheduled for August 13, 2002 at 9:00 a.m. EDT in a hearing room at the Hall of the States, 444 North Capitol St. NW, Washington, DC. The location of the hearing room will be posted at the Commission's offices in Suite 425. The second hearing will be open to comments on all aspects of the proposal

If you have any questions, please call Frank Katz at 505 982 4351.

FACTOR PRESENCE NEXUS STANDARD

- A. (1) A taxpayer has substantial nexus with this State sufficient to meet statutory and constitutional nexus criteria and is therefore required to file an apportioned income (franchise) tax return and, if due, pay an apportioned income (franchise) tax when in any tax period
- (a) the taxpayer's commercial domicile is in this State; or
- (b) the taxpayer as a natural person doing business in this State is a resident or domiciliary of this State
- (2) A taxpayer [has] [is presumed to have] substantial nexus with this State sufficient to meet statutory and constitutional nexus criteria and is therefore required to file an apportioned income (franchise) tax return and, if due, pay an apportioned income (franchise) tax when in any tax period
- (a) the taxpayer has nonbusiness income as defined in Uniform Division of Income for Tax Purpose Act (UDITPA) in this State in an amount over \$5000; or
- (b) the taxpayer meets the statutory standard for doing business in the State as demonstrated through the presence of property, payroll or sales in the State measured by the apportionment factors as they are defined below in Subsection B, in an amount in excess of the thresholds set forth in Subsection C.
- B. The apportionment factors are defined as follows:
- (1) The property factor is the average value of the taxpayer's real property and tangible personal property owned or rented and used during the tax period. Property owned by the taxpayer is valued at its original cost basis. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property. Property present in this State, using the same averaging method where appropriate, counts toward the threshold.
- (2) The payroll factor is the total amount paid during the tax period by the taxpayer for compensation. Compensation means wages, salaries, commissions

and any other form of remuneration paid to employees and defined as gross income under Internal Revenue Code § 61. Compensation is paid in this State if (a) the individual's service is performed entirely within the State; (b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or (c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

(3) The sales factor is the total dollar value of sales made during the tax period by the taxpayer that would be included in the sales factor under UDITPA, including sales to entities that are part of a commonly owned enterprise as defined in D(2) of which the taxpayer is a member. Sales of tangible personal property, intangible personal property and services made to a purchaser located in this State count toward the threshold. If the sale of a service or an intangible is made to a purchaser that uses the intangible or service partially within and partially without this State, the sale counts toward the threshold if the purchaser's commercial domicile is located in this State and no charge is made for the use of the intangible or service at different locations. If there is a separate charge for, or measured by, the use of the service or intangible in a State, then that portion of the receipts counts toward the threshold for that State, and not toward the threshold of the commercial domicile.

(4) Notwithstanding the other provisions of this subsection (B), for a taxpayer subject to the special apportionment methods under [Multistate Tax Commission Regulations IV.18.(d) through (j)], the property, payroll and sales factors are determined pursuant to those regulations for factor presence purposes. Financial institutions subject to an apportioned income or franchise tax shall determine property, payroll and sales factors according to the [MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions]. Utilities subject to an apportioned income or franchise tax shall determine their property, payroll and sales factors in the same manner as other taxpayers under (1), (2) and (3) above.

C. (1) Substantial factor presence shall be [established] [presumed to exist] if any of the following thresholds is exceeded during the tax period:

(a) for property the dollar amount of \$50,000 or 25% of the denominator of the property factor; or

(b) for payroll the dollar amount of \$50,000 or 25% of the denominator of the payroll factor; or

(c) for sales the dollar amount of \$500,000 or 25% of the denominator of the sales factor.

(2) At the end of each year, the [tax administrator] shall review the cumulative percentage change in the consumer price index. The [tax administrator] shall adjust the thresholds set forth in paragraph (1) if the consumer price index has changed by 5% or more since January 1, 2003, or since the date that the thresholds were last adjusted under this subsection. The thresholds shall be adjusted to reflect that cumulative percentage change in the consumer price index. The adjusted thresholds shall be rounded down to the nearest \$1,000. As used in this subsection, “consumer price index” means the Consumer Price Index for All Urban Consumers (CPI-U) available from the Bureau of Labor Statistics of the United States Department of Labor. Any adjustment shall apply to tax periods that begin after the adjustment is made.

D. (1) Entities that are part of a commonly owned enterprise shall determine their factor presence as follows:

(a) Commonly owned enterprises shall first determine the aggregate factor presence of all their entities that have a minimum presence in this State of \$5000 of the combined factors of property, payroll and sales. If that aggregate factor presence meets any threshold in Subsection C, the enterprise shall file a joint information return as specified by the [tax agency] separately listing the factor presence of each entity.

(b) Those entities of the commonly owned enterprise that are listed in the joint information return and that are also part of a unitary business conducting business in this State shall then separately aggregate their factor presence for each unitary business on the joint information return.

(c) If the aggregate factor presence in this State of the entities of any unitary business of the enterprise meets a threshold in Subsection C, then each entity that is part of that unitary business is deemed to have nexus and shall file and pay income or franchise tax as required by law.

(d) Each non-unitary entity of the commonly owned enterprise listed on the information return must file and pay tax if its own factor presence in this State separately meets any applicable nexus threshold, including meeting the thresholds in Subsection C, having nonbusiness income greater than \$5000, or having one’s residence, domicile or commercial domicile in this State.

(2) “Commonly owned enterprise” means a group of entities under common control either through a common parent corporation that owns, or constructively owns, more than 50 percent of the voting power of the outstanding stock or through five or fewer individuals (individuals, estates or trusts) that own, or constructively own, more than 50 percent of the voting power of the outstanding stock taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

- E. Factor presence of pass-through entities shall be determined on the entity level. If the presence of any factor of the entity in this State surpasses the nexus threshold, the members, partners or shareholders of the pass-through entity shall pay tax on the portion of income earned in this State and passed through to them. Pass-through entities that are part of a commonly owned enterprise shall aggregate their factors with the commonly owned enterprise under Subsection D.
- F. If a taxpayer does not provide the specific factor presence calculations in response to a formal request from the [tax agency] in order to allow a determination to be made under factor presence nexus thresholds, the taxpayer’s nexus may be determined under any facts and circumstances permitted by the constitutions of the United States and this State.